

In the Supreme Court

OF THE
United States

OCTOBER TERM, 1983

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ALEXANDER L. STEVAS.
CLERKPACIFIC GAS AND ELECTRIC COMPANY AND
SOUTHERN CALIFORNIA GAS COMPANY,*Petitioners,*

v.

TENNECO OIL COMPANY, *et al.*,*Respondents.*

**PETITION FOR WRITS OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE FIFTH CIRCUIT**

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Dated: February 29, 1984

QUESTION PRESENTED

Whether certain San Juan lease sale transactions, wherein oil and gas producers transferred vast proven reserves of natural gas to an interstate pipeline for the purpose of supplying the California market, are not subject to regulation under this Court's *Panhandle* decision (*FPC v. Panhandle Eastern Pipeline Co.*, 337 U.S. 498 (1949)) despite subsequent decisions of this Court in *Phillips* (*Phillips Petroleum Co. v. Wisconsin*, 347 U.S. 672 (1954)) and *Rayne Field* (*United Gas Improvement Co. v. Continental Oil Co.*, 381 U.S. 392 (1965)) that *all* wholesales of natural gas including wholesales under lease sale agreements are nevertheless sales of natural gas under the Natural Gas Act, 15 U.S.C. § 717, *et seq.*

LIST OF PARTIES

Public Agencies:

Federal

Federal Energy Regulatory Commission

State

People of the State of California

Public Utilities Commission of the State of California

Idaho Public Utilities Commission

Public Service Commission of Nevada

Public Utilities Commissioner of Oregon

Washington Utility & Transportation Commission

Public Service Commission of Wyoming

City

City of Ellensburg, Washington

Interstate Natural Gas Pipeline Companies:

El Paso Natural Gas Company

Northwest Pipeline Corporation

Distribution Companies:

Cascade Natural Gas Corporation

Colorado Interstate Gas Company

Intermountain Gas Company

Mountain Fuel Supply Company

Northwest Natural Gas Company

Pacific Gas and Electric Company

Rocky Mountain Natural Gas Company

San Diego Gas & Electric Company

Southern California Edison Company

Southern California Gas Company

Southern Union Company

Southwest Gas Corporation

Washington Natural Gas Company

Washington Water & Power Company

Producers:

<u>El Paso's System</u>	<u>Party</u>
GLA 47	Tenneco Oil Company Conoco, Inc.
GLA 51	Mapco, Inc. Hopi Oil Company
GLA 52	Tenneco Oil Company Conoco, Inc.
GLA 60	Tenneco Oil Company Conoco, Inc. Charles Colwill Anne Home Emerson, Trustee Anna Lou Home Jean E. Keyser Cassandra Keyser Teresa Home Barron Kidd Helen Ulmer van Atta
GLA 61	Sun Oil Company (Delaware)
GLA 62	FHN, Ltd.
GLA 63	Atlantic Richfield Company
GLA 66	W. Watson LaForce, Jr. Henry P. Isham, Jr. Estate Robert T. Isham Josephine C. Jacobson J. Roberts Jones Nancy LaForce Keyes Frederic P. G. Lattner, Trustee, U/T Martha M. Lattner, Settlor Suzanne LaForce Baber James C. Bard Douglas N. Bard Ralph A. Bard, Jr. Roy E. Bard, Jr. G. Brainard, Jr. Trust Continental Illinois National Bank and Trust Company, Trustee Trust #23935

El Paso's
System

Party

Continental Illinois National Bank and
Trust Company, Trustee Trust #23949
Eleanor Isham Dunne
Charles W. Farnham, Jr.
Robert B. Farnham
Walter B. Farnham
Elizabeth B. Farrington
Minnie A. Fitting
R. U. Fitting, Jr. Estate
Robert D. Fitting
Nancy H. Gerson
John R. Grimes
Ruth N. Halls
Cortland T. Hill
Elsie F. Hill
Louis W. Hill, Jr.
Albert L. Hopkins, Jr.
George S. Isham
R. S. MacDonald, A. MacDonald and
Northern Trust Co., Trustees
U/W of N. S. MacDonald, Deceased
Mary F. Love
William J. McDermott, Trustee
Nora R. Ranney
Catherine H. Ruml
Edward L. Ryerson, Jr.
Sabine Royalty Corporation
Shaw, Isham & Company
John I. Shaw, et al., Trustee
James Simpson, Jr. Trust
William E. Simpson Trust
Sydney Stein, Jr.
Northern Trust Co., Trustee, U/W of John Stuart
Robert Douglas Stuart Estate
William P. Sutter
Michael Simpson Trust
Patricia Simpson Trust
Katharine I. White

El Paso's
System

Party

	Kay B. Gundlach
	Frederick F. Webster Trust
	Mary S. Zick
	David Waller Dangler
GLA 72	Mapco, Inc.
	Hopi Oil Company
GLA 76	Union Oil Company of California
	First National Bank of Ft. Worth,
	Trustee for Eula May Johnston
	James J. Johnston
	V. A. Johnston Family Trust
	Jones Company
	Wm. C. McMahan Estate
	Homer R. Stasney & Sons Company
	Rogers-Gibbard Trust
GLA 77	Robert Beamon
	Robert Beamon, Trustee
	Pattie Ann Beamon Lundell
	Thomas L. Hall, Trustee
GLA 78	American Petrofina Company
	Tenneco Oil Company
	Conoco, Inc.
GLA 86, 101, 127	Mapco, Inc.
	Hopi Oil Company
GLA 106	Morris and Flora Mizel
GLA 122	Producing Royalties, Inc.
	Harold S. Long
	Dixie M. McLane, Trust
	Mrs. Judy St. John Taylor
	John S. White
GLA 125	American Petrofina Company
	Anderson Construction Company, Inc.
	Benson-Montin-Greer Drilling Corp.
	Tom Bolack
	Oliver Benson
	Albert R. Greer
	Mary Eddy Jones

<u>El Paso's System</u>	<u>Party</u>
	Edna Fern Benson
	Walter Benson
	Charlene K. Greer
	Mary E. Jones and The First National Bank & Trust Company of Oklahoma City, Trustees
	U/W of F. Jones
	Late Oil Company
	A. C. Montin, Jr.
	William V. Montin
	Oklahoma and Northwestern Company
GLA 129	Delta Drilling Company
	Trustees of the DeGolyer Foundation
	Mrs. Nell V. DeGolyer
GLA 139	Producing Royalties, Inc.
	James A. and Hazel H. Borland
	R. Lewis Chandler Trust
	Marcy C. Fannin
	Charles E. Graham, Jr.
	Newell R. Hays
	Dixie M. McLane Grandchildren's Trust
	Critchell Parsons
	Judy St. John Taylor
GLA 152, 160, 231	J. Glenn Turner
	Sue Reeder Turner Trust
	William G. Webb
GLA 153	Gretchen A. Gartner
	Helen L. Harvey
GLA 157	Mapco, Inc.
	Barbara Ann Bruss
	O. J. Lilly
	Barbara Irene McConnell
GLA 172	Crown Central Petroleum Corporation
GLA 195	William G. Webb
GLA 196	J. Glenn Turner
	Sue Reeder Turner Trust
	William G. Webb
	Benson-Montin-Greer Drilling Corp.

<u>El Paso's System</u>	<u>Party</u>
	Barbara Ann Bruss
	Charles Albert Greer
	La Plata Gathering System, Inc.
	O. J. Lilly
	Huerfanito Gas Co., et al., PP
	Barbara Irene McConnell
	Mary R. Boecking and
	H. E. Boecking, Jr., Trustees
	Jacqulyn M. Williams
GLA 197	Huerfanito Drilling Company, Inc.
GLA 198, 248	J. Glenn Turner
	Sue Reeder Turner Trust
	William G. Webb
	Frank A. Schultz
GLA 249	Benson-Montin-Greer Drilling Corp.
	Barbara Ann Bruss
	Charles Albert Greer
	La Plata Gathering System, Inc.
	O. J. Lilly
	Barbara Irene McConnell
	Mary R. Boecking and H. E. Boecking, Jr.
	Trustees, U/T of Mary M. Strachley
	J. Glenn Turner
	Sue Reeder Turner Trust
	Jacqulyn M. Williams
GLA 348	Union Oil Company of California
	Jones Company
	W. C. McMahan
	H. R. Stasney & Sons Company
GLA 349	Union Oil Company of California
GLA 350, 351	Robert Beamon
	Robert Beamon, Trustee
	Thomas L. Hall, Trustee
	Pattie Ann Beamon Lundell

<u>Northwest's System</u>	<u>Party</u>
PLA 2	Atlantic Richfield Company
PLA 3	Getty Oil Company
PLA 4	Grace M. Brown Catherine B. McElvain, Inc. and as Executive of Estate of T. H. McElvain, Deceased T. H. McElvain Oil and Gas Properties James E. McElvain, Executor of Estate of Carl R. McElvain
PLA 5	J. Wm. McElvain Estate of F.B. Miller Mabelle McElvain Miller Mrs. Ruth M. Vaughn Phillips Petroleum Company
PLA 6	Amoco Production Company J. Ralph Ellis, Jr. Jones Felvey, II First National Bank of Dallas for the Acct. of J. Ralph Ellis, Jr. McCulloch Oil Corporation Mountain States Natural Gas Corp. John D. Mugg, Jr. Jack B. Ryan Texas Oil & Gas Corp. U. V. Industries
PLAs 7, 9, 10, 11	Amoco Production Company
PLA 8	J. Ralph Ellis, Jr. Jones Felvey, II First National Bank of Dallas for the Acct. of J. Ralph Ellis, Jr. H. M. Meredity, Trustee Mountain States Natural Gas Corp. John D. Mugg, Jr. Amoco Production Company Jack B. Ryan Texas Oil & Gas Corp.
PLA 13	Mobil Oil Corporation
PLA 14	Champlin Petroleum Co.

In accordance with Rule 28.1, following are a listing of the parent companies, and non-wholly owned subsidiaries and affiliates of Southern California Gas Company and Pacific Gas and Electric Company:

Parent of Southern California Gas Company:

Pacific Lighting Corporation

Affiliates of Pacific Gas and Electric Company:

ANGUS Chemical Company

ANGUS Chemie Cmbh.

ANGUS Petrotech Corporation

Alberta Natural Gas Company, Ltd.

Pacific Gas Transmission Company

Standard Pacific Gas Line Incorporated

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Respondents.

**PETITION FOR WRITS OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE FIFTH CIRCUIT**

Petitioners Pacific Gas and Electric Company and Southern California Gas Company respectfully pray that writs of certiorari issue to review the judgments of the United States Court of Appeals for the Fifth Circuit entered on July 5, 1983 in Case Nos. 77-1762 and 80-2404.

OPINIONS BELOW

The opinion of the Court of Appeals is reported at 708 F.2d 1011 (1983) and is printed at Appendix 1a-19a.¹ In Case No. 80-2404, the Court of Appeals reversed a decision of the Federal Energy Regulatory Commission (FERC

¹The Appendix refers to the appendix filed in No. 83-1321, October Term, 1983, by The People of the State of California and the Public Utilities Commission of the State of California. (California) The Appendix, filed in a separate volume, contains all opinions issued in this matter.

or Commission) and, in Case No. 77-1762, affirmed a decision of a federal district court. The Initial Decision of the Administrative Law Judge (Benkin, J.), *El Paso Natural Gas Company*, Docket No. CP74-314, *et al.*, is reported at 6 FERC ¶ 63,037 (1979), and is printed at Appendix 33a-120a. The Commission's Order Affirming Initial Decision and Initiating Further Hearing, *El Paso Natural Gas Company*, Docket No. CP74-314, *et al.*, is reported at 12 FERC ¶ 61,296 (1980) and is printed at Appendix 21a-31a. The Commission's Order Denying Applications for Rehearing is reported at 13 FERC ¶ 61,239 (1980) and is printed at Appendix 153a-154a. The decision of the district court, *El Paso Natural Gas Co. v. Sun Oil Co.*, is reported at 426 F.Supp. 963 (W.D. Tex. 1977) and is printed at Appendix 121a-136a.

This Court should also be aware of the opinion of the Court of Appeals in 1978 (reported at 580 F.2d 722) in which it concluded that it should not decide the appeal from the district court until it had the benefit of the FERC decision. This opinion and an order clarifying it are found at Appendix 137a-144a. The point of the 1978 Fifth Circuit decision was to make clear that the Federal Power Commission (FPC), the predecessor to the FERC, and the FERC, pursuant to the doctrine of primary jurisdiction, should have an opportunity to decide the jurisdictional issue in this case as it involves the scope of the Commission's jurisdiction under section 1(b) of the Natural Gas Act, and that all parties would be bound by its determination. The FPC had not been a party in the case initiated by El Paso Natural Gas Company (El Paso) in federal district court. The Fifth Circuit in 1978 in effect accomplished the reference that El Paso had sought but the district court judge had not granted.

Administrative Law Judge Benkin's opinion is the only opinion that reviews in meaningful detail the rather remarkable history of the San Juan lease sale transactions. The substance of his opinion begins in Section III at Appendix 44a. There, Judge Benkin shows that the lease sale transactions were designed to avoid FPC jurisdiction in anticipation that the Phillips investigation, which commenced in 1948, would culminate in a ruling by this Court that the FPC had jurisdiction over independent producer sales of natural gas. Appendix 44a-51a. Judge Benkin, in Section IV, describes the geology of the San Juan Basin and notes that prior to the San Juan lease sales transactions the parties, supported by engineering studies, considered the reserves underlying the lease sale properties to be proved. Appendix 52a-56a. In Section V, he describes in detail the events that led to the first of the lease sales at issue in this litigation, as well as the terms of that agreement, which is known as GLA-47. Appendix 56a-61a. GLA-47 is the most important of the lease sale transfers on El Paso's system. In Section VI, Judge Benkin describes the events that led to the remaining GLA lease sale transactions and in Section VII, he discusses the entry of Pacific Northwest Pipeline Corp. into the Basin as well as the events that led to the lease sale transactions on Pacific Northwest's system. Appendix 61a-86a. Judge Benkin, in Section VIII, reviews the relevant authorities, including this Court's decision in *Phillips (Phillips Petroleum Co. v. Wisconsin*, 347 U.S. 672 (1954)) and *Rayne Field (United Gas Improvement Co. v. Continental Oil Co.*, 381 U.S. 392 (1965)), and *Bastian Bay (FPC v. Pan American Petroleum Corp.*, 381 U.S. 762 (1965)), as well as the Fifth Circuit decision in *Ship Shoal (Continental Oil Co. v. FPC*, 370

F.2d 57 (5th Cir. 1966), *cert. denied*, 388 U.S. 910 (1967)). Appendix 86a-104a. In Section IX, he applies the law to the facts of this case. Appendix 104a-119a.

STATEMENT OF GROUNDS ON WHICH JURISDICTION IS INVOKED

1. The Court of Appeals for the Fifth Circuit concluded that the San Juan lease sale transfers involved in this proceeding were not sales for resale under § 1(b) of the Natural Gas Act, 15 U.S.C. § 717b. In so ruling, the Fifth Circuit reversed a FERC determination that the transfers were sales under Section 1(b) and affirmed an earlier federal district court ruling that the transfers were not sales under Section 1(b). The FERC had jurisdiction pursuant to §§ 4, 5, 7, 8, 14, and 16 of the Natural Gas Act, 15 U.S.C. §§ 717c, d, f, g, m and o. The district court has jurisdiction pursuant to 28 U.S.C. § 1331 and § 22 of the Natural Gas Act, 15 U.S.C. § 717u. The Commission, however, was not a party to the district court proceeding; the district court declined to refer the jurisdictional issue in this case to the Commission under the doctrine of primary jurisdiction.

2. The Court of Appeals entered judgments on July 5, 1983. Appendix 145a, 149a. The Court of Appeals denied rehearing on December 2, 1983. Appendix 151a-152a.

3. The jurisdiction of this Court is invoked under 28 U.S.C. § 1254(1) and § 19(b) of the Natural Gas Act, 15 U.S.C. § 717r(b).

STATUTORY PROVISION INVOLVED

Section 1(b) of the Natural Gas Act, 15 U.S.C. § 717(b) provides:

"The provisions of this act shall apply to the transportation of natural gas in interstate commerce, to the sale in interstate commerce, to the sale in interstate commerce of natural gas for resale for ultimate public consumption for domestic, commercial, industrial, or any other use, and to natural gas companies engaged in such transportation or sale, but shall not apply to any other transportation or sale of natural gas or to the local distribution of natural gas or to the facilities used for such distribution or to the production or gathering of natural gas."

STATEMENT OF THE CASE

After the conclusion of World War II, the demand for gas in the northern and central California market served by Pacific Gas and Electric Company (PGandE), and the southern California market served by Southern California Gas Company (SoCalGas) was rapidly expanding and would soon outstrip the ability of existing dedicated reserves to meet that demand. Appendix 44a. One promising source of gas was the San Juan Basin, which contained both substantial resources of natural gas and was relatively close to the markets of PGandE and SoCalGas. In 1947, Delhi Oil Company advised PGandE that independent geologists estimated Delhi's net recoverable hydrocarbons at Barker Dome, to the northwest of the San Juan Basin, at 1.3 trillion cubic feet. R. 6939. It was already apparent that the Basin also contained significant gas in place, especially in the Blanco (Mesaverde) gas field. R. 6946. A major producer, Stanolind Oil & Gas Company,

the producing arm of Standard Oil of Indiana, controlled 10,000 acres and was about to start drilling. R. 6946.

The one impediment to full development of the Basin was the lack of a market because no interstate pipeline had reached the Basin. On August 25, 1947, El Paso filed an application with the Federal Power Commission seeking a certificate of public convenience and necessity for construction and operation of a pipeline from the San Juan Basin to a point at the Arizona-California border near Needles, California. Appendix 45a. El Paso sought to serve the growing markets of PGandE and SoCalGas. El Paso still needed the gas supply necessary to support its application. On May 1, 1948 Delhi agreed to sell its Barker Dome gas to El Paso under a conventional producer-pipeline gas sales contract; the initial 1948 contract was replaced with a second one in early 1949. Appendix 45a-47a. Both contracts contained an express condition precedent that enabled Delhi to cancel it if the FPC did not provide Delhi with a declaratory order that it would not become a regulated seller by virtue of the proposed sale. Appendix 47a. When the Commission proved unable to provide Delhi with clear guidance that it would not be regulated, Delhi advised that it would not go forward with the sales contract. Appendix 49a-50a.

In response to the regulatory uncertainty, the parties transformed their gas sales contract into a lease sale. Judge Benkin described what happened this way:

"Delhi's counsel in Dallas sought the advice of Charles V. Shannon, a Washington lawyer specializing in FPC law and the Commission's one-time General Counsel, in a letter of December 1, 1949. Shannon expressed the opinion that if Delhi, instead of going through with its then-pending wellhead sale contract

with El Paso, were to transfer its Barker Dome reserves through a sale of the underlying leases, the transaction would be non-jurisdictional and would not make Delhi subject to regulation by the Federal Power Commission. In light of Shannon's opinion and the confusion surrounding the legal status of independent producers, the parties decided to renegotiate and recast the second gas-purchase contract in the form of a lease-sale agreement. Under the lease-sale format, Delhi would sell its gas leases covering the Barker Dome acreage to El Paso, and El Paso would undertake the production of natural gas from the acreage. Delhi would receive compensation for the gas in an amount roughly equivalent to the per-Mcf price it would have received under the gas-purchase contract, minus El Paso's production costs.

The most significant factor in the arrangement was this: the lease-sale format was developed specifically for the purpose of putting the independent producer and the pipeline in about the same economic positions they would have enjoyed under a conventional well-head gas sale contract. From the standpoint of the parties to the first lease-sale agreement, the primary purpose—and perhaps the sole purpose—of using that format rather than a conventional wellhead gas sale contract was to avoid the possibility that independent producers who sold their gas to interstate pipelines under such a contract would be held to be natural-gas companies subject to the Federal Power Commission's regulatory jurisdiction."

Appendix 49a-50a (footnotes deleted).²

²This Court in *Rayne Field* no doubt assumed that the lease sale format did not develop until after *Phillips*. In fact, the Barker Dome lease sale agreement was the first of the jurisdictional lease sales. Appendix 105a. Delhi's aversion to regulation led to the develop-

Based largely on the Barker Dome reserves dedicated to El Paso under the Delhi-El Paso lease sale agreement, but also based upon reserves held by Stanolind in the then proven area of the Blanco Field, the FPC in the summer of 1950 authorized El Paso to build the San Juan line. *San Juan Pipe Line Co.*, 9 F.P.C. 170 (1950). El Paso began to deliver gas from the San Juan area to California in July 1951. Appendix 51a.

Because the demand for natural gas in California continued to grow, and sources of natural gas within California were expected to decline, PGandE and SoCalGas continued to seek new out-of-state sources of supply, including additional supply from the San Juan Basin. R. 7852; R. 7075,76.³ By the summer of 1951, PGandE and SoCalGas learned that the proven area of the Blanco (Mesa-verde) Field was at least twice as large as one year earlier (R. 7073), and exploration and development activities in the Basin were greatly accelerated over the previous year. R. 7074. El Paso advised in June 1951 that it anticipated

ment of the lease sale alternative to a conventional producer-pipeline sales contract. The producers in this litigation have never seriously argued that Barker Dome was not a jurisdictional sale under *Rayne Field*. Rather, they have argued that it was irrelevant. They so persuaded the District Court (Appendix 125a, n. 5), but the FERC correctly perceived its relevance (Appendix 44a-51a, 112a-113a).

³"As the demands of the California market increased, El Paso was once again confronted with the urgency of obtaining new gas supplies in order to maintain its position as California's primary gas supplier." Appendix 57a.

that it would be able to make the reserve showing* necessary to support substantial additional deliveries from San Juan by the time of the next FPC hearing. R. 7074.

In December 1951, El Paso advised that it had entered into a memorandum agreement with Delhi to acquire Delhi's undedicated reserves in the Basin. R. 7075. The definitive contract is now known as GLA-47. It followed the same plan as the Barker Dome contract. R. 5059, Appendix 57a, 105a. It set the pattern for all other lease sales involved in this litigation. Appendix 61a, 105a.

PGandE and SoCalGas appreciated that Delhi's San Juan reserves were the key to future San Juan deliveries by El Paso and that El Paso had no alternative but to acquire dedication of the Delhi reserves. R. 8001-03. As Judge Benkin explained:

"By early 1951, Delhi had acquired huge reserves of natural gas in the Blanco-Largo and Kutz Canyon-Angel's Peak Fields of the San Juan Basin, both of which were located to the Southeast of the Barker Dome Field. It was clear to El Paso that, in order to support its pending FPC application to increase its natural gas service, it would have to obtain dedication of the vast Delhi reserves to the El Paso system. This was the case for two reasons. First, the Delhi reserves were uniquely large enough to provide the volumes needed to support the application. Second,

*To secure authorization to construct a new pipeline or to expand an existing one for increased sales, a pipeline must make a showing of dedication of adequate gas supply. See 18 C.F.R. § 157.14(10) (discussing Exhibit H); for the requirements in the late 1940's, see 18 C.F.R. § 157.6 (discussing Exhibit F), Exh. 40 EP 1815. Historically, "it was necessary for a gas pipeline company, in order to obtain certificates, to expand their facilities to have a 20-year reserve life index and a 12-year deliverability life." R. 20404.

the unique strategic location of the Delhi reserves permitted them to be rapidly introduced into El Paso's pipeline system, thereby providing the deliverability that El Paso needed to demonstrate to the Commission.

El Paso at first attempted to purchase the gas from Delhi at the wellhead. It offered an initial base price of 7.33 cents per Mcf plus longevity escalations. Delhi rejected the offer on the ground that the price was too low. El Paso then approached other independent producers in the area, seeking to make wellhead sales contracts. But those producers, aware of El Paso's urgent need for the dedication of new reserves and of Delhi's strong bargaining position, refused to consummate sales to El Paso until the outcome of the negotiations with Delhi became known. Hence, El Paso was forced to deal with Delhi first. Unable to obtain the gas reserves it needed through the medium of conventional wellhead sale contracts, El Paso sought to purchase Delhi's leases in a transaction similar in form to the Barker Dome sale that had taken place in 1950."

Appendix 57a.

El Paso kept PG&E and SoCalGas apprised of the negotiations. They knew that the transaction would take the form of a lease sale. Further, they assured El Paso that they would be willing to assist in the financing of the cost of development. R. 8001-03; R. 7088-90.

Probably because participation in the financing was under consideration, PG&E and SoCalGas in late 1951 commissioned DeGolyer & MacNaughton (D&M) to estimate the recoverable reserves from Delhi's undedicated acreage. Exh. T-DD. In a report as of March 1, 1952, D&M advised that, based on then existing engineering and geo-

logical data, 80,000 (out of 102,246) acres were proved for gas production from the Mesaverde formation, that the gross recoverable Mesaverde reserves were 966 billion cubic feet (Bcf), that the average Mesaverde well would have an initial open flow capacity of 1,000 Mcf/day, and that the average Mesaverde well would have an average initial deliverability (against the gathering line pressure) of 700 Mcf/day. R. 9824; R. 9827. Further, based on the development program in GLA-47 itself, D&M advised that development of the proved Mesaverde acreage should be completed by year-end 1955, less than four years from date of closing. R. 9828. D&M projected that production from GLA-47 would be 3.8 Bcf in 1952 (10 mos.), 27 Bcf in 1953, 44 Bcf in 1954, 55 Bcf in 1955, and would decline thereafter at about 6% per year. R. 9832; R. 9827. D&M estimated that about 66% of the reserves would be produced by 1971, and that the total reserves would be recovered in 40 years. R. 9827.⁵

Once Delhi was committed under GLA-47, other producers became willing to dedicate their reserves to El Paso under lease sales similar to GLA-47. Judge Benkin described what happened:

"It was as if the execution of GLA 47 had broken a logjam.

After the March 1, 1952 closing of GLA 47, El Paso's program of acquiring gas reserves in the San Juan Basin

⁵D&M's estimate, as of March 1, 1952, did not materially differ from Delhi's estimate in November 1951, prior to GLA-47. Delhi estimated the recoverable Mesaverde reserves at 1.064 Tcf, and estimated production at 15 Bcf in year one, 39 Bcf in year two, 61 Bcf in year three, and 64 Bcf in year four, with production falling to 55 Bcf in year five, and declining moderately thereafter. R. 9692.

through purchases similar to the so-called 'Delhi deal' proceeded rapidly. In all, the pipeline made 36 lease-sale contracts with the owners of gas leaseholds in the Basin, thereby acquiring the gas underlying more than a quarter of a million acres.

Although it took some six and one-half years to consummate all of the agreements, the large tracts were acquired early in the program. Almost two-thirds of the acreage (some 65.6% of it) was under contract by January 1953, a year after execution of the first GLA, and the contracts for more than 80% (82.5%) of the acreage had been signed by July 8, 1953, some 18 months after GLA 47 came into being."

Appendix 61a.

The GLAs became an important source of supply for PGandE and SoCalGas almost immediately upon closing. Again, as Judge Benkin wrote:

"Upon consideration of all the evidence about the state of geological information, it is clear that the volumes of gas involved in this proceeding were definable within reasonable parameters, and that all of the leaseholds at issue here held reserves that were imminently producible in commercial quantities. Events bear out this analysis; shortly after the lease-sale agreements were closed, the acreage was developed, attached to the pipelines, and actually produced volume of gas in quantities sufficient to supply the requirements of these major interstate natural gas pipelines."

Appendix 107a.

Under the GLAs, the producers are paid overriding royalties that became known as special overriding royal-

ties. These special overriding royalties are payable on the producers' entire net interest in the leases that were assigned to El Paso under the GLAs.⁶ In the case of GLA-47, for example, Delhi's net interest in the underlying leases was about 70% and as a result, El Paso in GLA-47 was obligated to pay Delhi in cents per Mcf as the gas was produced on 70% of the total GLA-47 production.

As explained in some detail in California's petition for writ of certiorari, El Paso in recent years has been paying the producers under the GLAs the NGPA § 102 price (for new natural gas) less seven cents per Mcf on (in the case of GLA-47) 70% of total production. This price is several times the NGPA § 104 flowing gas price. Further, the producers receiving this enormous flow of revenue for old gas do not bear any cost of production. If the GLA transactions were in economic effect sales of gas, then El Paso could not lawfully pay in special overriding royalty more than the applicable ceiling price, depending on the vintage and type of gas, less its costs of production.⁷ Based on PGandE and SoCalGas' theory of remedy, the refunds due from the GLA producers for the period June 1, 1974-September 30, 1983, exceed one billion dollars. El Paso will retain none of these refunds. The ultimate beneficiary of refunds would be the consumer in California, as well as

⁶This is total volume less base royalty and fractional (conventional) overriding royalty. Base royalty was $\frac{1}{8}$ (12.5%). Fractional overriding royalty (due to trading in leases) totalled 17.5%. This left a special overriding royalty volume of about 70%.

⁷If the GLA transactions are in economic effect sales of gas, then the payments to the producers are "conventionalized," which means that the producers in effect receive the same net income that they would earn if the gas is valued at applicable ceiling prices and the producers operated the properties at El Paso's costs.

east-of-California in market areas where distribution companies purchase natural gas from El Paso. Because California is by far El Paso's largest market, customers of PGandE and SoCalGas have been the most injured by the excess payments made to the producers.

REASONS FOR GRANTING THE WRITS

PGandE and SoCalGas are vitally interested in having the propriety of FERC's decision below confirmed and the Court of Appeals reversed. Over one billion dollars is at stake, and, with much of El Paso's gas going to California, the consumers in California will bear the brunt of the lower court's mistake in this case, involving enormous and unfair overcharges. In *Rayne Field (United Gas Improvement Co. v. Continental Oil Co.*, 381 U.S. 392 (1965)), this Court advised the Commission that it should make a case-by-case analysis of the substance of a lease sale transaction to determine whether the producers were making wholesales of gas through the lease sale form. *See* 381 U.S. at 404. If the substance of the lease sale was a wholesale of gas, the sale was a regulated transaction.

The decision below eviscerates the case-by-case approach directed by the Court in *Rayne Field*. Here, the agency, unlike the district court, had the expertise to analyze the evidence, the applicable precedent, and then to ascertain the true substance of the lease sale transfers. It, of course, knew the position of the district court, yet found the facts differently and reached a different jurisdictional conclusion. As might be expected in this unusual and delicate situation, the agency was especially careful to document the facts and recite the law which supported its jurisdictional determination.

The Court of Appeals did not interfere with the Commission's investigation in recognition that it was entitled to make the jurisdictional determination in the first instance under the doctrine of primary jurisdiction. Appendix 137a-141a.* Further, the Court of Appeals does not dispute the critical facts found by the agency—namely, that large reserves were transferred under the GLA transactions, that the transactions are the economic equivalent of conventional sales, and that under the lease sales large reserves were dedicated to the interstate market for resale. The Court, however, finds no jurisdiction based on the view that in most instances substantial development drilling took place after the lease sale transfers. (Significantly, even under the Court's mistaken construction of *Rayne Field*, the evidence, as determined by Judge Benkin, showed "... that all of the leaseholds at issue here held reserves that were imminently producible in commercial quantities." Appendix 107a. Thus, the Court of Appeals should have seen that the evidence fully supported a finding of substantial development drilling prior to transfer.)

In reversing the FERC, the Court of Appeals, while perceiving the issue as "difficult" (Appendix 11a), does not give the Commission the benefit of any deference at all. The Court's opinion ignores the Commission's reasoning that the paramount holding of *Phillips* and then of *Rayne Field* was that the Natural Gas Act placed *all* wholesales of natural gas under regulation.

*Indeed, the Fifth Circuit, in a clarifying order entered on October 25, 1978, made it clear that all parties would be bound by the Commission's determination. A copy of this order is attached as Appendix 143a-144a.

Because the Court of Appeals did not even discuss the facts of its own *Ship Shoal*^{*} case, it did not understand that it, too, had previously recognized in *Ship Shoal* that the paramount holdings of *Phillips* and *Rayne Field* did not require development drilling to accomplish a jurisdictional lease sale. The agency discussed the facts, meaning, and holding of *Ship Shoal* at length (Appendix 94a-97a). Its discussion shows that development drilling is not a requisite to a jurisdictional lease sale, and that the Fifth Circuit so held in *Ship Shoal*. The agency's accurate statement of the holding in *Ship Shoal* escaped entirely the attention of the Court of Appeals. Clearly, if the doctrine of primary jurisdiction is to have some force, a court reversing a well-considered agency determination should at least point out either that the agency misconstrued the court's own prior precedent or explain how the prior proceeding was not sound law. The Court of Appeals did not do either; instead, it simply ignored that in *Ship Shoal* it had firmly held that a lease sale of substantially proven reserves in an undeveloped field was nevertheless jurisdictional. 370 F.2d at 67.

Rather than face up to the substance of *Phillips*, *Rayne Field* and its own holding of *Ship Shoal*, the Court of Appeals undertook to revive the old *Panhandle* case (*FPC v. Panhandle Eastern Pipeline Co.*, 337 U.S. 498 (1949)) and then based on its reading of *Rayne Field* stated: "We perceive the *Rayne Field* test to reflect the Supreme Court's concern with the apparent congressional intent not to regulate production. A purely economic test would seem to encroach on that concern." Appendix 15a.

^{*}*Continental Oil Company v. FPC*, 370 F.2d 57 (5th Cir. 1966), cert. denied 388 U.S. 910 (1967).

However, this perceived concern was flatly rejected as irrelevant by this Court in *Phillips*, again in *Rayne Field*, and also by Judge Wisdom in *Ship Shoal*. In *Phillips*, this Court wrote that the "production or gathering" exemption was applicable only to the "physical activities, facilities, and properties used in the production and gathering of natural gas." 347 U.S. at 678. In *Rayne Field*, this Court's position was that an economic test did not encroach on state regulation of production because: "the 'production or gathering' exemption relates to the physical activities, processes and facilities of production or gathering, but not to sales of the kind affirmatively subjected to Commission jurisdiction." 381 U.S. at 402. Judge Wisdom made the same point in *Ship Shoal*: "If such sales were not subject to Commission regulation, an 'attractive gap' in the regulatory system would be created, and the producing states would be unable to close it." 370 F.2d at 67. Thus, the perceived concern that led the Court below to overturn the Commission's jurisdictional determination has no bearing on whether a lease sale is in substance a jurisdictional sale.¹⁰

¹⁰The decision below also cites Judge Leventhal's opinion in *Mobil Oil Corp. v. FPC*, 463 F.2d 256 (D.C. Cir. 1971), *cert. denied*, 406 U.S. 976 (1972). *Mobil* holds that an ordinary lease is not a jurisdictional sale. The panel opinion cites *Mobil* for the proposition that all *Rayne Field* factors, including substantial development, by which we think the panel means substantial development wells as was the case in *Rayne Field*, must be present. However, a review of Judge Leventhal's opinion at the pages cited by the decision below (261-62) show that Judge Leventhal was distinguishing *Rayne Field* and an ordinary lease. He was not focusing on a lease sale transaction, pursuant to which a producer assigns leases to a pipeline under terms that are entirely foreign to an ordinary lease (e.g., such as payment on the entire net interest transferred, rapid

It is clear under this Court's decision in *Phillips Petroleum Co. v. Wisconsin*, 347 U.S. 672 (1954)) and under *Rayne Field* that the Commission has jurisdiction over all wholesales of natural gas. There is no exception. It is true that in *Rayne Field* this Court said that the more that "the substantiality of development is a relevant consideration, for the more that must be done before the gas begins its interstate journey, the less the transaction resembles the conventional wellhead sale of natural gas in interstate commerce . . .". 381 U.S. at 403. However, this Court surely did not have in mind the situation, like San Juan, where reserves over large areas can be proved up by a few strategically placed test wells, and the producer, having proved up his reserves, offers them for sale to an interstate pipeline through a lease sale transaction.¹¹ The producer is still selling gas, and his sale is jurisdictional.

development obligation, favored nations clauses, and so forth). Indeed, Judge Leventhal, in his discussion on p. 261, states that *Rayne Field* applies where a producer transfers "a lease of reserves" where the transaction is "in economic impact the equivalent of 'conventional sales of natural gas' . . .". For him the key was economic equivalency; surely he would have been in agreement with Judge Wisdom's *Ship Shoal* decision and the Commission's jurisdictional determination here.

¹¹In fact, a producer under a conventional sale will not devote capital for the purpose of drilling gas development wells until the pipeline is ready to take the gas. This was especially true in San Juan where the number of wells needed to develop was known due to state spacing rules, the cost of development wells was predictable and inexpensive (\$80,000), and the wells did not take long to drill (a month or less). Moreover, a producer in Delhi's position will not drill gas development wells if he can impose that obligation on the pipeline, make the pipeline develop rapidly, and receive essentially the same profit as under a conventional sale. By not committing his capital to gas development wells, he conserves his capital for oil exploration or development.

As Judge Benkin's comprehensive decision shows, the San Juan lease sales were of necessity jurisdictional. El Paso was required to show the FPC that the reserves were proven in order to obtain certificate authority to make major new sales to the California companies. PGandE and SoCalGas encouraged El Paso to obtain dedication of the reserves because the shortage of natural gas was acute in California after World War II. So immediate was the need for the gas that PGandE and SoCalGas considered assisting El Paso in financing the Mesaverde wells needed to complete development on GLA-47. While such assistance in the end was not needed, it is apparent that it would not have been offered unless the reserves were large, ready for sale, and deliveries could commence immediately.

The FERC faithfully discharged its *Rayne Field* duty, as well as its obligation under the doctrine of primary jurisdiction, to investigate the San Juan lease sale transactions. Based on a thorough investigation, it found that these sales were jurisdictional, as they clearly were. It is equally apparent that the decision below does not acknowledge the regulatory change brought about by *Phillips*. Instead, the decision below revives the old *Panhandle* case, and creates an exception to the universal rule of *Phillips* and *Rayne Field* that all wholesales of natural gas are under regulation.

CONCLUSION

In dissent in *Rayne Field*, Mr. Justice Douglas equated *Panhandle* with "a shadow of an ancient landmark." 381 U.S. at 406. Because the decision below revives *Panhandle* and is in conflict with the principles of *Phillips* and *Rayne Field*, as well as in conflict with settled agency doctrine established in the 1960's and confirmed in *Ship Shoal*, PGandE and SoCalGas request that this Court grant their petition for writs of certiorari.

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